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Ex Parte

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: 1993/1994 Annual Access Tariff Filings; CC Docket Nos. 93-193, 94-65

Dear Ms. Dortch:

In its October 5, 2004 *ex parte* letter, AT&T concedes, as it must, that the Commission is not ordering refunds in this investigation as a penalty,[1] but then nevertheless argues that the Commission should penalize the local exchange carriers ("LECs") that did not apply add-back in their 1993 and 1994 annual access tariffs by ordering interest at the higher IRS corporate overpayment rate rather than at the IRS corporate overpayment rate for payments in excess of $10,000 (the "large corporate overpayment rate"). There is no basis for a penalty here. There was no clear rule requiring add-back prior to the 1995 rule change – the matter was far from settled at the time and the Commission only resolved the issue on a going-forward basis when it adopted the new add-back rule in 1995. The only reason that the Commission is imposing interest in this case is to compensate customers for the time value of money, and even AT&T must concede that the large corporate overpayment rate would achieve that purpose in this investigation.

AT&T's entire argument is premised on the need to penalize the LECs for not applying add-back. As is demonstrated in the cases cited by AT&T, interest normally is assessed simply

[1] *See 1993/1994 Annual Access Tariff Filings*, 19 FCC Rcd 14949 at ¶ 20 (2004) ("*Add-back Order*") ("requiring refunds does not amount to a penalty; it merely requires the return of revenues to which the LECs were not entitled in the first place").

to compensate customers for the use of their money while the investigation was pending.[2] A higher rate is applied only as a penalty if the Commission finds that the carrier knew that the Commission had already found similar conduct to be unlawful. To support the imposition of the higher corporate interest rate to add-back refunds, AT&T relies on *GCI v. ACS*, where the Commission imposed that rate rather than the compensatory large corporate overpayment interest rate because ACS had "constructive knowledge" that it was unlawful to assign traffic of Internet service providers to the interstate jurisdiction. This was based on the fact that the Commission had already rejected as unlawful the attempts of other carriers to do the same.[3] This case makes it clear that the Commission does not apply the higher corporate overpayment interest rate unless it finds that the LECs should be penalized for doing something that the Commission has already found to be unlawful.[4]

There is no basis for imposing penalty interest to the add-back refunds, because the Commission clearly had *not* found that it was unlawful not to apply add-back prior to the 1995 rule change. AT&T makes several arguments that the Commission had ruled on this issue prior to 1995, but none are supported by the record.

First, AT&T argues that the Commission's finding in 1990 that sharing and lower formula adjustments were intended to be one-time adjustments to a single year's rates, so as not to affect future earnings, made it clear that add-back was required. To the contrary, as many LECs argued at the time, add-back could be seen as *contradicting* this finding, because it creates an additional sharing obligation in the subsequent year by increasing the carrier's rate of return

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[2] *See* AT&T Letter at 4, *citing Long-Term Number Portability Tariff Filings*, 14 FCC Rcd 17339, ¶ 5 (1999) ("*LNP Order*") ("we believe that carriers, who consequently had use of the end users' money during this period, should compensate them for this overpayment").

[3] *See General Communications, Inc. v. Alaska Communications Systems Holdings*, 16 FCC Rcd 2834, ¶ 74 (2001) ("*GCI v. ACS*").

[4] Neither of the other two cases cited by AT&T (at 4) supports its argument that the higher corporate overpayment rate would not amount to a penalty. In the *LNP Order*, the Commission ordered interest at the IRS individual overpayment rates, which were one percentage point higher than the corporate overpayment interest rate, only because the customers who were receiving refunds in that case were primarily *individuals*, *i.e.,* end users, not corporations. *Long Term Number Portability Tariff Filings*, 14 FCC Rcd 17339, ¶¶ 4-5 (1999) ("*LNP Order*") ("we believe that carriers, who consequently had use of the end users' money during this period, should compensate them for this overpayment"). In the *Western Union* case, the Commission ordered interest at the corporate overpayment rate, rather than at the large corporate overpayment rate, for the simple reason that there was no large corporate overpayment rate at the time. *See Western Union Telegraph Co*., 10 FCC Rcd 1741, ¶¶ 38-39 (adopted Dec. 28, 1994, released Jan. 5, 1995). *Western Union* was decided in 1994, and the IRS did not issue a large corporate overpayment rate until 1995.

in the previous year.[5] In addition, the Commission *removed* the add-back adjustment from the Form 492 rate of return reports when it adopted price caps, creating more uncertainty, and there were disagreements even among LECs as to whether add-back survived the transition to price caps.[6]

Second, AT&T cites the Court's decision upholding the Commission's 1995 add-back rule to argue that add-back was self-evidently part of price caps prior to the 1995 rule change. However, the Court explicitly found that "[t]he state of the law *has never been clear*, and the issue has been disputed since it first arose in 1993. . . . Petitioners made their X-factor decisions in the face of *considerable uncertainty* about whether the 1990 *LEC Price Cap Order* included add-back."[7] Consequently, the Court confirmed that "[t]he sharing rules, including the add-back rule, are purely prospective."[8]

Third, AT&T points to the Commission's decision to investigate the 1993 and 1994 tariffs to determine if add-back was unlawful as putting the local exchange carriers on notice that add-back was required. However, the carriers cannot be expected to presume from the fact that the Commission investigates a tariff that the Commission has prejudged the outcome of the case. The Commission made it clear when it investigated these tariffs that "the issue is unresolved."[9] Moreover, the Commission also investigated the tariffs of the NYNEX companies, which *did* apply add-back. By AT&T's logic, NYNEX should have concluded from the investigation orders that the Commission had found its application of add-back to be unlawful. Obviously, no carrier can be expected to assume that its tariffs are unlawful when they are investigated or be penalized for not predicting the results of the investigation. And, if the result of those investigations were as obvious as AT&T now claims, it is inconceivable that it would have taken the Commission ten years to resolve the issue.

Fourth, AT&T argues that the Commission's 1993 notice of proposed rulemaking to adopt the add-back rule gave the LECs constructive notice that add-back was already required. However, the Commission's *Add-back NPRM* proves just the opposite.[10] In that order, the Commission recognized that "this issue was neither expressly discussed in the LEC price cap orders nor clearly addressed in our Rules."[11] The *Add-back NPRM* presented several policy

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[5] *See, e.g.,* Comments of Verizon at 9 (filed May 5, 2003).

[6] *See id.* at 8.

[7] *Bell Atlantic v. FCC*, 79 F.3d 1195, 1207 (D.C. Cir. 1996) (emphasis added).

[8] *Id.*, 79 F.3d at 1206.

[9] *1993 Annual Access Tariff Filings*, 8 FCC Rcd 4960, ¶ 32 (Com. Car. Bur. 1993); *see also 1994 Annual Access Tariff Filings*, 9 FCC Rcd 3705, ¶ 12 (Com. Car. Bur. 1994).

[10] *See Price Cap Regulation Of Local Exchange Carriers Rate of Return Sharing and Lower Formula Adjustment*, 8 FCC Rcd 4415 (1993) ("*Add-back NPRM*").

[11] *Id.*, ¶ 4.

reasons for adopting the add-back rule on a prospective basis, but it never attempted to show that the rule was already part of price caps or that it applied to the current tariffs. The rulemaking order proposed to adopt rules that would apply prospectively, and not to determine the lawfulness of tariffs filed before the rules were to be changed. In the 1995 order adopting add-back, the Commission observed that "[w]e do not decide in this rulemaking whether an add-back adjustment is required for purposes of the 1993 and 1994 Annual Access Tariff Filings."[12] It was not until 9 years later that the Commission finally decided whether add-back was required prior to the rule change.

In addition, AT&T's basic premise that the "LECs should have known what they were doing – applying add-back where it increased access charges and not applying add-back where it decreased access charges – would be found to be unlawful" is factually incorrect. None of the LECs who were ordered to submit refund plans applied add-back, even where, as in the case of the GTE companies that had lower formula adjustments in some states, it would have increased their access charges.[13] The Commission cannot find that the LECs acted in bad faith or in contradiction to any clear guidance from the Commission.

Finally, it would be fundamentally inequitable to apply a punitive interest rate to the LECs where they had to make their tariff filings in an environment where, in the Court's words, "the law has never been clear" and "in the face of considerable uncertainty" and where the Commission itself then took ten years to resolve the issues while interest accrued.

Accordingly, the Commission should apply the only interest rate that it clearly compensatory in these circumstances – the IRS corporate overpayment rate for payments in excess of $10,000.

Sincerely,

/s/Joseph Mulieri

Attachment

cc: Tamara Preiss
Deena Shetler
Julie Saulnier

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[12] *Price Cap Regulation of Local Exchange Carriers, Rate of Return Sharing and Lower Formula Adjustment*, Report and Order, 10 FCC Rcd 5656, n.3 (1995).

[13] *See* Verizon Refund Plan at 11-12 (filed Aug. 30, 2004). The former NYNEX companies did apply add-back, which initially increased their access charges because they were had lower formula adjustments in the early years of price caps. *See* Verizon Comments at 3-4. However, this was not unlawful, and the Commission ordered no refunds for the NYNEX companies.